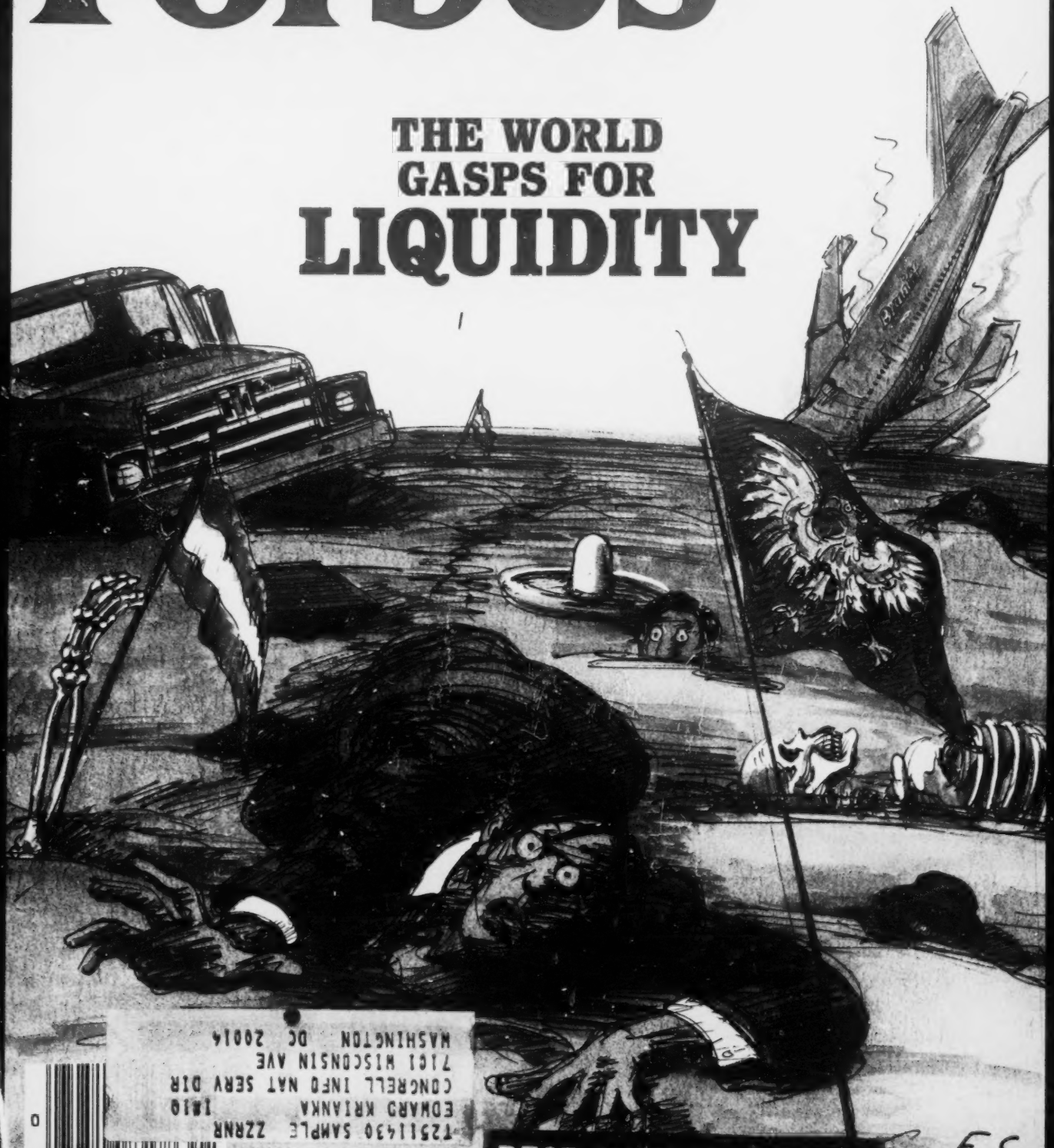
OCTOBER 11, 1982 TWO DOLLARS AND FIFTY CENTS

Forbes

THE WORLD GASPS FOR LIQUIDITY

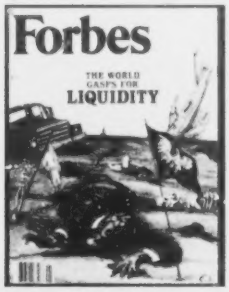


T25114J0 SAMPLE ZZRNR
EDWARD KRIANKA 1810
CONGRELL INFO NAT SERV DIR
7161 WISCONSIN AVE
WASHINGTON DC 20014

74820 08317

BEST AVAILABLE COPY

October 11, 1982
Volume 130,
Number 8



***150** Cover Story: The game is over.*

***43** BAT: No longer just throwing money at it.*

***73** The Up & Comers: "Just hang in there, buddy, because those who get impatient will sell out cheap."*

39 Aerospace:
The Big Dogfight
And somebody is going to go down in smoke.

40 Cable Television:
The Strong Get Stronger
CBS Cable may be only the first to go; the shakeout is closer than most realize.

41 Companies:
Pittston Co.
In the pits with "Mr. Coal."

42 Monaco:
Pavane For A Dead Princess
A tragic loss—in business terms, too.

43 Companies:
British American Tobacco
The pieces are falling into place.

45 Fast-Food Chains:
The End Of The Burger Boom?
Believe it or not, Americans may be getting jaded about one of their favorite foods.

51 Distribution:
Productivity Is More Than Robots
Eight ways to turn a dull business into a glamorous business.

58 Companies:
Sysco Corp.
The secret: paying attention to details.

60 The Up & Comers:
New Hampshire Ball Bearings
Japan Inc. versus *Our Town*.

73 The Up & Comers:
McRae Industries
Opportunity came knocking—in the form of combat boots.

93 Profiles:
Michael Swerdlow
Turning liabilities into assets for bankrupt companies sounds like alchemy. Actually, it's just good business.

98 Bankruptcies:
Don't Cry For Manville's Creditors
They could have—and should have—known.

102 Companies:
Payless Cashways
For 50 years it has been giving its managers generous incentives. Clearly, the practice has paid off.

108 Companies:
Tucson Electric Power
A little fancy footwork always helps.

112 Companies:
H. J. Heinz Co.
Hold prices. Lower costs. Raise advertising.

118 Companies:
Data General
As it has before, it is once more coming from behind. But this time, the maverick of minicomputers almost waited too long.

124 Companies:
Pan American World Airways
One definition of desperation: selling used planes to a glutted market.

130 Companies:
Fleetwood Enterprises
A multiple of 22—for an RV maker?

132 Wall Street:
The New Breed
They aren't called "floor traders" anymore.

139 Companies:
United Industrial Corp.
The virtues of benign neglect—sort of.

144 Companies:
Logicon Inc.
"Why bother if we can't build a company?"

147 Tax Shelters:
A Yardstick Of Performance
Rating how well your shelter shelters.

150 Cover Story:
Who Will Pay The Piper? Who Won't?
Given some good news from Mexico, the worst of the liquidity squeeze may be over.

156 The Military:
Hail And Farewell
The jeep is dead. Long live the Humvee?

161 Taxing Matters:
The Tax Shelter Nobody Wants
And for very good reasons, as it turns out.

164 The Funds:
Janus Fund
The satisfactions of nondogmatism.

166 Companies:
Primark Corp.
Putting the heat on an old boss.

168 Companies:
Tishman Realty & Construction Co.
A famous name wants a piece of the action.

172 Fast Food:
Frank Carney's Back Again
Why settle for a mere $300,000 a year?

93 *Profiles: "What Swerdlow says he's going to do, he does."*

102 *Payless: the do-it-yourself do-it-yourselfer.*

172 *Entrepreneur Frank Carney: "When you stop growing, you start dying."*

250 *Leveraged buyouts: Bigger is not necessarily better.*

183 Language:
A Few Words On Business
Ever wonder where "sub rosa" comes from?

190 The Money Men:
Michael O'Higgins
Aggressive in defeat, cautious in success.

192 Companies:
Control Data Corp.
If you think it's nerve-wracking dealing with U.S. unions, try Korea's.

196 Research:
Easier Said Than Done
A great idea that will take some time.

202 The Numbers Game:
The Banks' Foreign Loan Exposure
How much do they really have to tell you?

206 Technology:
Transaction Processing
For all the talk about personal computers, there's still need for the leviathans.

212 Personal Affairs:
The Market In Your Pocket
A portfolio of gadgets that will give you stock quotations wherever you are.

Faces Behind The Figures

226 Thomas Differ,
Getty Oil Co.
226 Stephen Kroft and Dean Dunlavey,
Sony v. Universal
227 Mario Perillo,
Perillo Tours
227 Victor Brown,
Firestone Tire & Rubber Co.
228 Thomas O'Reilly,
Juki Office Machine Corp.
228 Hans Seidel,
Deputy Finance Minister of Austria
233 Jacques Voorhees,
Polygon DTN, Inc.
233 W. Ashley Verlander,
American Heritage Life

238 The Streetwalker:
An Old Game With New Rules
Playing the disinflationary recovery.

240 Statistical Spotlight:
A No-Name Shopping List
What happens when the blue chips falter?

250 Leveraged Buyouts:
A Few Cautionary Tales
Sometimes, everybody loses.

Money And Investments

33
What's Ahead For Business
34
The Forbes Index
235
The Forbes/Wilshire 5000 Review

Columnists

253
Ben Weberman
254
Srully Blotnick
256
Ashby Bladen
258
Richard B. Hoey
260
Thomas P. Murphy
262
Stanley W. Angrist

Departments

6
Side Lines
10
Trends
16
Follow-Through
23
Readers Say
27
Fact and Comment
30
Other Comments
266
Editorial Index
267
Flashbacks
268
Thoughts

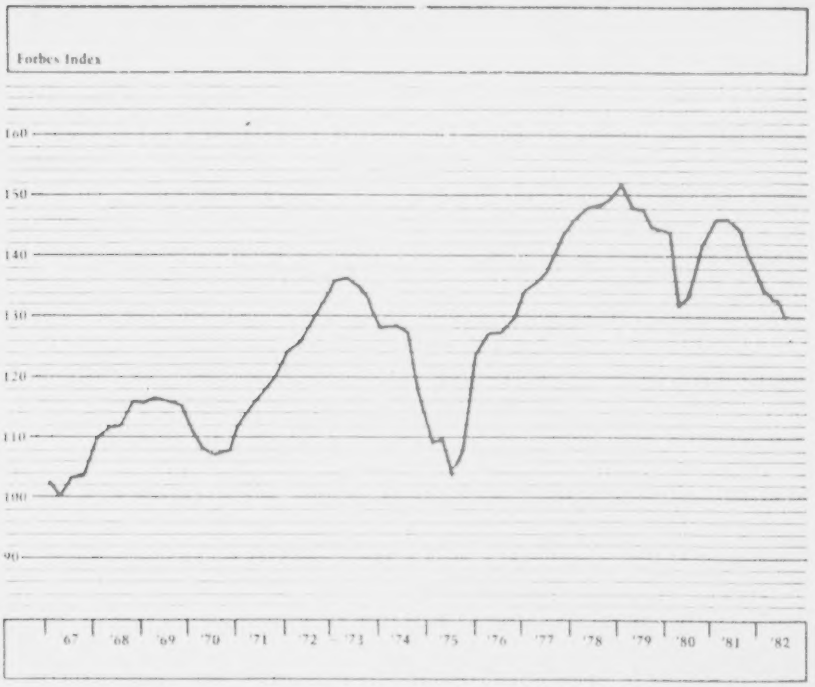
Photos:
10, Larry Smith/Black Star; 12, 238, UPI; 42, B. Melloul/Sygma; 43, 44, Robin Laurence; 46, Dan McCoy/Black Star; 51, 56, Arnold Zann/Black Star; 52, Peter Calvin/Camera 5; 60, 61, 118, Steve Liss/Liaison; 68, 132, 148, 227 middle and bottom, Bill Kelly; 73, Steve Murray; 93, Jim Pozarik; 102, Hank Young/Black Star; 108, Tucson Citizen; 112, 168, 190, Joyce Ravid; 129, Jim Sugar/Black Star; 130, 144, 226 top, 227 top, Jim McHugh; 139, 233 bottom, Paul Solomon; 151 Evonne Hemsey/Liaison; 154 top, Wide World; 154 bottom, T. Kotody/Sygma; 164, Carl Iwasaki; 166, Eric Smith/Liaison; 177, Bill Grimes/Black Star; 194, Roland Neveu/Liaison; 212, Eric Poggenpohl; 215, Joe McNally/Camera 5; 226, Dan Wheeler; 228 top, Tom McCarthy; 228 bottom, Fred DeVan; 233 top, Judith Gefter

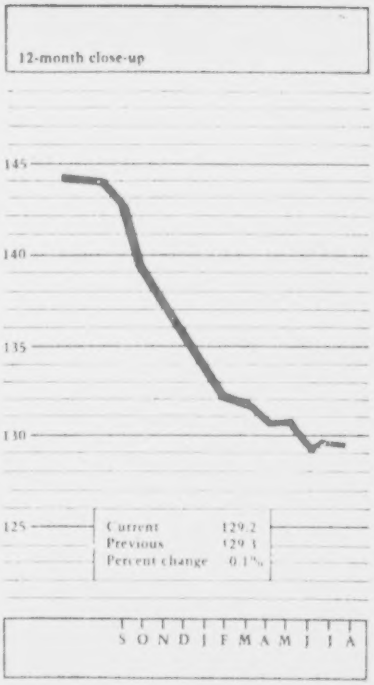
Illustrations:
6, By permission of Bill Mauldin and Wil-Jo Associates, Inc.; 98, 161, 183, 184, 185, 202, Chas. B. Slackman

Cover:
Ed Sorel

Forbes (ISSN 0015 6914) is published biweekly by Forbes Inc., 60 Fifth Ave., New York, N.Y. 10011. Second-class postage paid at New York, N.Y. and at additional mailing offices. Subscription $33 a year, U.S.A. Postmaster: Send address changes to Forbes, 60 Fifth Ave., New York, N.Y. 10011. Copyright © 1982 Forbes Inc. Title is protected through a trademark registration in the U.S. Patent Office.

The Forbes Index





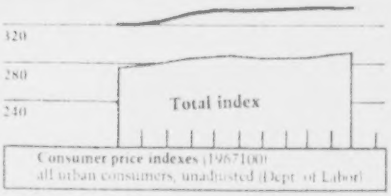
Another false start. After rising for two consecutive reporting periods, the Forbes Index has turned down again. And once more the reason is that consumers have failed to spend. Consumer credit increased by only $570 million, compared with a $1,349 million gain the previous month. At the cash register that translates into a 0.9% drop in retail store sales in August, following a slight rise of 1.2% in July. Consumers were also paying back borrowings. Debt liquidations are up by 5.1%.

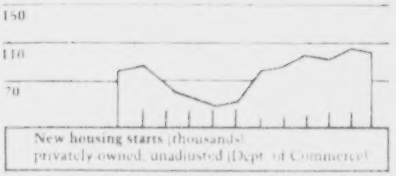
A look to the long term also reveals negative news. New housing starts fell by 13.1%. That's all the more disappointing because it follows a 17.6% gain a month earlier. The story is the same with industrial production for August, which dipped 0.5% after rising 0.7% in July.

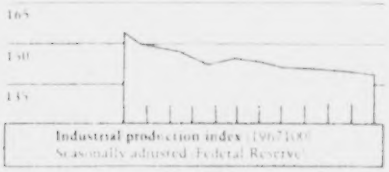
The Forbes Index Components

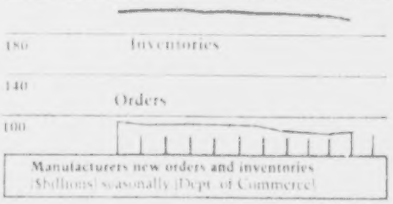
The Forbes Index is a measure of U.S. economic activity composed of eight equally weighted elements. **Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, the level of new orders for durable goods compared with manufacturers' inventories, total retail sales, new housing starts, personal income, the change in the amount of consumer installment debt outstanding.**

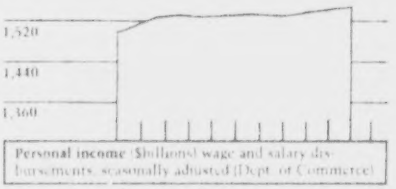
To measure these eight elements, Forbes monitors 11 series of U.S. government data. The last 14 months' data for each series is presented at right.

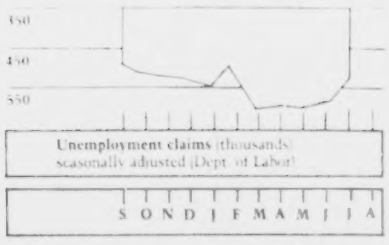


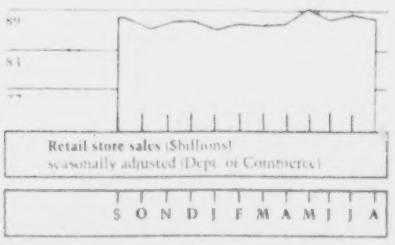


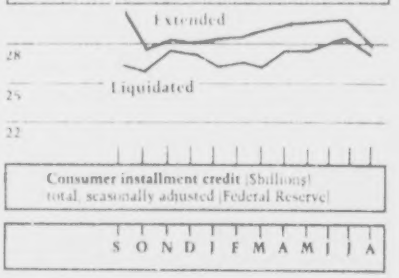












Worried that your oil and gas tax shelter isn't paying off? Wondering whether to try one? Here an industry analyst sets forth some performance yardsticks.

How does your shelter shelter?

By Jean A. Briggs

OIL AND GAS tax shelter programs are not all created equal. Some have returned as much as 110% aftertax to investors at the end of their term. Others have returned nothing at all. How do you tell which will do well and which won't before you plunk down your $10,000 and become a limited partner?

Arthur Jerrold King, president and founder of Investment Search, Inc. of Annapolis, Md., has been working on the problem. After graduating from the University of Oklahoma, where he studied accounting, he became a salesman for one of the major oil and gas program sponsors. One problem he encountered was the dearth of good information for investors. So he started up his own business providing summaries of the prospectuses of SEC-registered programs.

Soon King saw patterns in the offerings. He concluded that there are four basic types of programs. He has just completed a study that analyzes the impact on aftertax return of program size, amount of front-end load and type of drilling.

King's study covers 500 partnerships put together by 64 sponsors before 1981. All the sponsors were still in business and raised money in 1981. But the money raised from the public before 1981, some $2.5 billion, had been put to work and uncovered either gushers or dry holes. Although the oil and gas in successful wells may flow for another 20 years or more, the ultimate return on the investor's dollar can at least be projected. King's conclusion for the 500: a disappointing average return of 9.9%, down susbtantially from 12.8% two years ago. King attributes this decline to the many new and inexperienced entrants in the business.

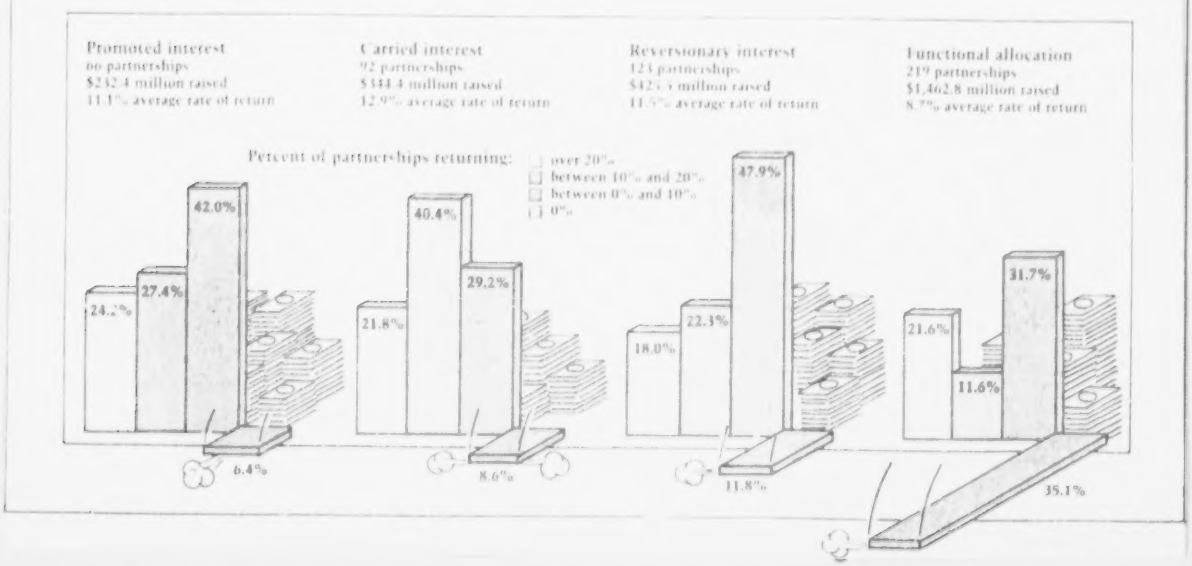
If the general partner and the limited partners shared both nondeductible capital costs and deductible drilling costs, King found that the limited partners' chances of a decent return were best. He calls this a *promoted interest* structure. Sixty-six of the 500 partnerships used it and raised $232.4 million. Twenty-four percent of these will return over 20%; only 6.4% will have no payout at all.

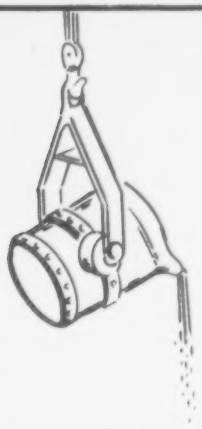
The reason the promoted interest structure is the safest for investors is that the general partner and the limited partners have the same interest. Says King: "He is at risk when he drills, just as you are."

The riskiest type of program to limited partners turned out to be the one King calls *functional allocation*. In such programs capital costs are paid by the general partner. Intangible or drilling or deductible costs are paid by

How is the deal structured?

A new study of oil and gas tax shelters finds partnerships with a promoted interest structure, where general and limited partners share all costs and revenues, proved safest. Those with functional allocation, where deductible costs are paid by outsiders and capital costs by sponsors, proved riskiest.





NAR has one of the nation's largest independent grey iron foundries. More than half the U.S. built cars have one or more castings produced by these modern, high quality, high volume, cost efficient plants.

NAR finds and develops oil and gas in this continent. For more than twenty years we have developed our own reserves and production from prospects generated internally or within the industry. Our professional staff directs operations from strategically located offices.

For the past five years our growth has been financed entirely by internally generated funds. We plan to continue this policy which has given us steady and substantial growth and financial strength.

NORTH AMERICAN ROYALTIES, INC.

CHATTANOOGA, TN 37402

NAR

the limited partners. Because investors can write off in the first year everything they put in, functional allocation is the most popular type of program. "Investors like it but they usually pay too much for it," says King. Of the 500 partnerships, 219 were of this type. While 21.6% of them can be expected to return over 20% to investors, 35.1% will have no payout at all. Even these figures may paint too rosy a picture. Among those returning over 20% are two big sponsors, Dyco and Woods Petroleum, which have more liberal payout terms or stronger financing. "If these two programs were removed from the sample, the percent which returned over 20% would decline to 13%," says King.

In the other two program structures King has defined, limited partners pay essentially all of the costs. "The general partner pays 1%," says King, "but he gets that in a management fee. He doesn't have to reach in his pocket for any cash." In one he calls *carried interest*, the general partner shares in revenues from the first barrel produced. In the other, labeled *reversionary interest*, the sponsor doesn't begin to share in revenues until after the investor gets at least some money back.

Surprisingly, the carried interest structure turned out to be more favorable for investors than the reversionary interest structure. Of the 92 partnerships with a carried interest structure, 21.8% will return over 20%; 40% over 10%; 29.1% under 10%; and 8.6% nothing at all.

Of the 123 programs with a reversionary interest structure, 18% will return over 20%; 22.3% over 10%; 47.9% under 10%; and 11.8% nothing at all. Both these structures are used primarily by new sponsors who don't have much cash, says King. "The problem with reversionary interest is it gives them an incentive to charge higher fees than they really should, since they don't get a stream of income as early as those with a carried interest structure."

But how can you tell what kind of structure the deal you are considering has? It won't be labeled "functional allocation" or "carried interest" in the prospectus. Your broker might know, but he might not. "The answer," says King, "is to study carefully two particular sections which are in every prospectus. One is called 'Use of Proceeds,' the other, 'Allocation of Costs and Revenues.' These will tell you who is paying for what and who is getting what. Remember, you want to be sure the sponsor's interest is closely tied to your own, that you are really in it together."

Tax shelter analyst King
"Study two sections carefully. . . ."

What do you look for beyond structure? One of the most important factors, says King, is the type of drilling—was it exploratory, developmental or a combination of the two? He found that in his sample investors fared best in developmental programs and worst in exploration programs. That's because of the far heavier downside risk for exploratory programs. Only 6.9% of the developmental partnerships will not pay out, as opposed to 34.4% for those concentrating on exploration.

As for size, King maintains that large amounts of money are not necessarily good. "Companies that do well with a few million can go back to the market and raise larger sums. They usually didn't do as well after that." Partnerships that raise between $5 million and $7 million showed the best average rate of return; larger partnerships proved to be the riskiest—with a 36.8% nonpayout ratio.

Front-end load turned out to be more important than King had expected. Programs with a load of under 5% showed a projected 17.8% rate of return, while those with a load of over 20% had an average of 9.1%.

Other factors important to investors' chances, says King, include the sponsor's technical expertise, his management ability and his track record. One of King's competitors, Robert A. Stanger in Fair Haven, N.J., recently ranked over 600 programs according to past performance. He and King agree that sponsors who have done well in the past tend to continue to do well as long as they don't make major changes in, for example, drilling personnel or location.

The truth, of course, could be that all this analysis is for nought—that finding oil and gas is really just a matter of luck. But to the extent that experience and skill influence the outcome, King's effort is a large step toward creating a useful yardstick. ■

The worst may be over but the outlook is for a slowdown in trade, investment and economic growth as international lending stands still. How fast things improve is beyond the reach of bankers. The world economy is now in the hands of its politicians.

The world gasps for liquidity

By Norman Gall

THE GRAND DESIGNS of statesmen and economic planners, when they go wrong, are ultimately reflected in simple pictures like the one on the facing page, taken in August in Mexico City. There, in a city whose population has quadrupled (to 14 million) in just the past 20 years, where human and wheeled traffic is now as dense as any nightmarish gridlock in midtown New York or even downtown Cairo, an oil-rich government suddenly out of cash and credit was forced to stop work on an urgently needed subway expansion, throwing thousands of men out of work.

Go almost anywhere in the world today and it is no trick at all to find essentially the same paradox—need, resources close by and no money in hand to marry one to the other. Underlying the paradox is a simple fact: A period of worldwide credit expansion of a magnitude unparalleled in history is now over.

Only yesterday, it seems, bankers were flush with deposits and jetting everywhere on earth, eager to lend to bustling, ambitious borrowers. The same bankers today, overextended and frightened, are jetting home with discouraging news of foundering economies and insolvent borrowers pleading for time and more credit. It is as if everyone—rich and poor alike, capitalist and socialist, advanced and developing—were making the rounds of a giant Monopoly game board and the rules suddenly changed. Instead of cheerfully forking over $200 automatically each time the player passes "Go," the bank now gives the player a hard time and just maybe, grudgingly, $50 in hopes of keeping everyone, not least the frightened bank, in the game.

It's no game, of course. In Mexico and elsewhere the sudden withdrawal of credit is, to use a scandalously overused and too often misapplied word, a full-fledged crisis whose cost must be reckoned in ruined lives and dangerously strained social structures. Can the crisis be contained? Or must the cost, bitter as it already is, escalate to a point where no one with a business to run or even a dollar or a peso in a bank can hope to escape sharing in it?

The quick answer is no, no one will escape paying at least some portion of the cost. After greater reflection the answer is still no, but there is the hope that the world's bankers and borrowers can come up with better strategies to contain the damage and build a new base for renewed growth.

It only seems as though the world is suddenly gasping for liquidity. In fact, the crisis was clearly foreshadowed. Thus, in its issue of June 23, 1980, under the headline "How much more can the system take?" FORBES reported:

"The world seems to be on a merry-go-round of inflation and there is no way for one country or one businessman to say, 'Stop the merry-go-round, I want to get off.' Since 1973 the price of oil, lifeblood of modern industry, has been jacked up by an extortionate 1,000%. That this hasn't caused a massive world depression is due principally to the unexpected ability of the world's commercial banks, with minimal help from their governments, to recycle the flood of petrodollars that piled up."

It was quite a party while it lasted. The 1970s witnessed the biggest credit boom the world has ever seen, with commercial bank credit expanding two or three times faster than real economic growth. In the major industrial countries over the past two decades, commercial bank credit expanded two or three times as fast as real economic growth—by 10% a year in the U.S., 12% in Germany, 16% in Britain and 20% in Japan—with a dramatic acceleration in the 1970s even as growth was slowing down.

The Eurocurrency market grew from $100 billion in 1970 to nearly $2 trillion today. Central bank reserves (with gold at market prices) expanded from $92 billion in 1970 to a peak of $800 billion in the third quarter of 1980.

These assets fueled an inflation the likes of which nobody has ever seen, with world consumer prices nearly tripling during the 1970s, against increases of 60% in the 1950s and in the 1960s. Ready credit and interest rates lower than inflation rates had the initially exhilarating effect of lightening debt loads, seducing governments, companies and individuals to borrow even more. Mexico's foreign debt quadrupled in the last seven years, breeding a 14-fold expansion of domestic credit at the same time. The debt/equity ratio of companies everywhere deteriorated. Investors put more money into government paper, less into productive tools.

A little-known Hungarian economist, the late Melchior Palyi, could not possibly have been thinking of Mexico or Argentina or Poland today, or of Drysdale Government Securities or Banco Ambrosiano or the Penn Square Bank of Oklahoma City, when he wrote a decade ago in his brilliant study *The Twilight of Gold, 1914-1936*, that in the 1920s "the domestic systems of the debtor countries had been greatly expanded under the stimulus of foreign loans and could not make sudden adjustments without fresh credit injections from abroad. Credit structures of the chief creditor countries had in turn become too weak to withstand the repercussions of the debtors' breakdown. That breakdown was a 'deadly' shock only because the creditors themselves were overextended." Then as now, in

While corn was selling for 11 pesos per kilo, the Mexican government was selling corn to tortilla factories for 1 peso. By such means, subsidies and transfer payments last year amounted to 31% of the federal budget and 15% of the national product.

short, strong lenders rarely have anyone but themselves to blame when weak borrowers get them in trouble.

How the credit boom artificially expanded living standards throughout the world is neatly summed up in what may be called the parable of the tortilla, the little unleavened corn cake that is the staple of the Mexican diet, as told by José López Portillo, whose six-year term as president of Mexico, ending in December, coincides with that rich but desperately wracked country's slide toward financial chaos. "The case of the tortilla is dramatic for its psychological, I dare say magical, implications," López Portillo said in his last annual message. "To the Mexican peasant corn is the basic source of food, coinage, religion, tradition and security, as well as his salary, since he works on his own. When we raise the price of corn there's applause. But we cannot ever forget that corn is used to make tortillas. To protect the consumer the state subsidized the tortilla until it reached an unmanageable extreme. While corn was selling for 11 pesos per kilo on the free market, the government was selling corn to tortilla factories for 1 peso."

By such means, according to López Portillo, government subsidies and transfer payments last year amounted to 31% of the federal budget and 15% of the national product, which deepened and widened the financial hole Mexico tried to fill by printing money at home and borrowing abroad.

Mexico was spending its own wealth and its borrowed capital on much more than subsidized tortillas, of course. Between 1977 and 1981 Pemex, the state oil company, invested $27 billion in new oil, gas and petrochemical production. That sum is roughly double all of the World Bank's lending to Latin America in the same period. Since 1976 Mexican oil production has grown from 800,000 to 2.85 million barrels daily. Mexico's proven reserves, meanwhile, have risen from 6.3 billion to 72.8 billion barrels—fourth largest in the world—and probable reserves, to 250 billion barrels, approaching the size of Saudi Arabia's. But the borrowings required to keep such ambitious schemes going could not be sustained indefinitely, FORBES had said in 1980, citing history to disprove bankers' arguments that sovereign states never default on their debts. The article continued:

"We now face a tough choice: Either we accept continued, possibly accelerating inflation, or we accept a slowing of world economic growth. Either course poses incalculable risks to rich nations and poor nations, capitalist states and socialist states alike."

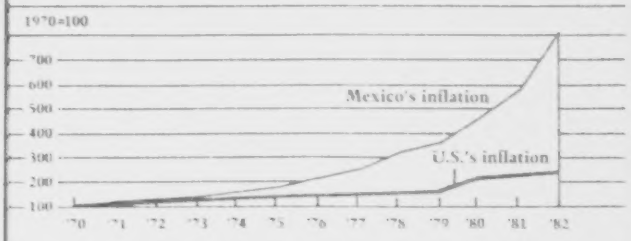
Mexico City street scene, August 1982
The story of great designs gone wrong can often be told in simple pictures.

López Portillo calls the world credit boom a "financial pestilence" akin to the Black Death: "As in medieval times, it flattens country after country. It is transmitted by rats and it yields unemployment, misery, industrial bankruptcy, enrichment by speculation."

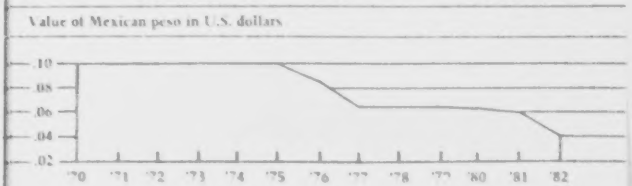
The present world liquidity crisis has forced grossly indebted nations like Mexico to choose slower growth. Political leaders are predictably frustrated by the consequences and loath to accept any responsibility for their fate. In his melodramatic speech before the National Congress last month announcing the nationalization of Mexico's private banks, López Portillo called the world credit boom of the past decade a "financial pestilence" akin to the Black Death that swept Europe in the 14th century. "As in medieval times, it flattens country after country," he said. "It is transmitted by rats and it yields unemployment and misery, industrial bankruptcy and enrichment by speculation. The remedy prescribed by faith healers is forced inactivity and depriving the patient of food."

Rise and fall

While prices more than doubled in the U.S., they octupled in Mexico where foreign debts totaling $80 billion bred a 14-fold expansion of domestic credit.



That inflation differential brought unbearable pressure on the peso, formally devalued twice in six years and otherwise allowed to float down.



Harsh words. Yet Mexico, with lots of oil in the ground and sure of its power as the developing world's most privileged borrower, courted what its president now calls a pestilence. "You've got to give the bankers something new all the time," said Angel Gurria, López Portillo's suave young director of public credit, as he was gearing up for a tripling of Mexico's foreign borrowing (to $14.5 billion) in 1981. "You've got to keep them entertained."

Bankers north of the border were so entertained that outstanding U.S. bank loans to Mexico expanded from $5.5 billion in 1978 to $22.4 billion by the end of 1981, with the gentlest of interest-rate spreads (as little as 0.125%) above the London Interbank Offered Rate, the baseline for international lending. Thanks to the great appetite of Mexican officials and to the great foolishness of foreign bankers, Mexico's scheduled debt service for 1982 amounted to $43 billion, nearly one-fifth of the national product and triple the estimated oil export earnings for the year.

After nearly doubling during 1981, U.S. bank exposure to Mexico grew by another one-fourth in the first five months of 1982, despite the country's deepening financial troubles. According to diplomatic sources in Mexico City, not only have the nine biggest U.S. money center banks committed 40% of their combined capital to Mexico, but several U.S. regionals have lent the equivalent of all their capital, with large amounts committed to Grupo Industrial Alfa, the fast-growing Monterrey conglomerate that defaulted in April with $2.3 billion in debts to 130 foreign banks. With inflation surging to nearly 100% this year, with public spending out of control and government deficits amounting to 15% of the national product, Mexico's credit collapsed after Alfa stopped paying its bankers.

As in Mexico, oil rich but with heavily protected industry, so with Chile, Argentina and Uruguay, taking economic advice from University of Chicago-trained economists preaching an open economy to free the movement of capital and goods. So, too, with Poland, Rumania and other Eastern European borrowers under the "Soviet umbrella" that, bankers had thought, would guarantee loans made to them.

In all of these nations the credit boom remorselessly led to distortions and bankruptcies. In Costa Rica, which imports all its oil, in Venezuela and Nigeria, which export oil, in Argentina and Bolivia, which are self-sufficient in oil—in all of these, the inflow of vast sums of money led to enhanced appetites for consumption, giant deficits in government spending and in international payments, and increased inflation.

No country could rationally absorb the huge sums they were receiving under the best of circumstances. Add fear into the bargain—especially fear of what inflation does to life savings—and human nature takes over. With their pesos overvalued, Argentinians, Chileans, Uruguayans and Mexicans found investment in the U.S. irresistibly cheap. So banks acted as turntables, taking a portion of the money they had brought in right back out again to be invested in U.S. real estate, CDs and Treasury bills. Of some $16 billion in foreign capital, most of it short term, that flooded into Argentina between the first quarters of 1979 and 1981, Argentine nationals sent $12 billion out of their country again to spend on tourism, appliances, condos in Florida and, of course, nest eggs in foreign banks.

In announcing nationalization of Mexico's private banks on Sept. 1, López Portillo accused these same banks of "heading, advising and supporting" a capital flight by Mexicans "who took more money out of the country than all the imperialists that have exploited us in all our history." In all, he said, $22 billion had left the country this way over the past two or three years, while Mexicans had

Note the popularity among many politicians today of the buzzword "reactivation." Argentina tried it at the end of the Falklands war, pegging interest rates at half or one-third the rate of inflation. The result: Inflation of up to 855% (annualized) now rages.

incurred private debts of $17 billion to pay mortgages, maintenance and taxes on newly acquired property. "They already have looted us," López Portillo said. "They will not loot us again." There was $12 billion in dollar-denominated accounts left in Mexican banks on the day López Portillo took them over. Much of that, presumably, was kept there by people who trusted his management of the economy. But López Portillo does not consider the forced conversion of those dollars into debased pesos to be a form of looting.

The choice confronting governments everywhere becomes clearer every day: credit contraction or uncontrolled inflation. The politicians will decide.

In his *Monetary Reform* (1924), written in the wake of the great hyperinflations in Germany and other European countries after World War I, John Maynard Keynes observed: "The active and working elements in no community, ancient or modern, will consent to hand over to the *rentier* or bondholding class more than a certain proportion of the fruits of their work." When debt burdens become intolerable, he added, the government resorts to repudiation or devaluation (inflation), which wiped out two-thirds of the French and all of the German public debt in the 1920s.

To deny that such a nightmare could return would be foolish. Note the popularity among many politicians today of the buzzword "reactivation." Is business bad? Demand weak? Interest rates and taxes too high? Everybody up to his neck in debt? Let's try a little "reactivation."

Argentina's leaders tried "reactivation" at the end of the Falklands war to "save" banks and companies wallowing in bad debt—about one-third of all outstanding credit—in the worst financial crisis any country has seen since the Great Depression. A new president of the central bank suddenly decreed that interest rates would be pegged at half or one-third the rate of inflation. Predictably, there was a run on the banks. Anticipating just that event, the central bank replaced vanishing private bank deposits with newly printed money, thus nationalizing the credit system. The inevitable result: Argentina is heading toward hyperinflation, with wholesale prices rising over the past three months at an annual rate of 855%.

In Mexico, after the nationalization of the banks and the imposition of exchange controls, another new central bank president decreed interest rates far below inflation levels. That sent savers out on a spending spree and is forcing the central bank to print more money, which will fuel even more inflation.

In the U.S., too, they're talking about "reactivation." Some congressmen want to pass laws controlling interest rates in order to "save" the auto and housing industries. Reagan advisers talk about legislation to control the Federal Reserve Board more closely because Chairman Paul Volcker is, by law, beyond its reach.

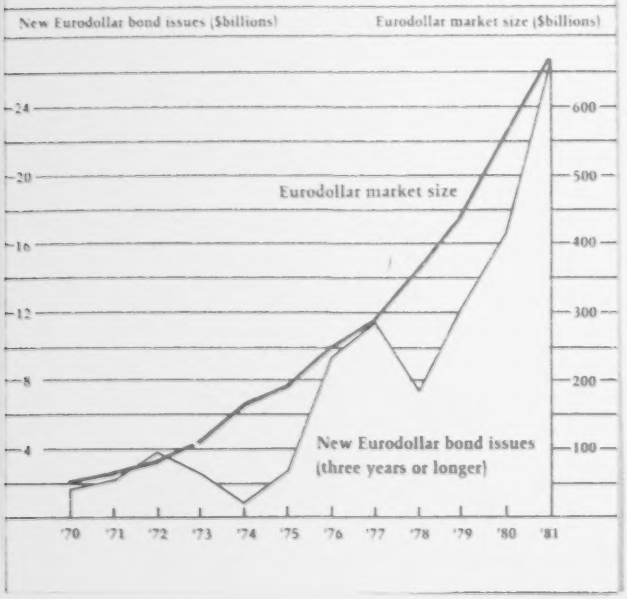
The one hopeful thing about "reactivation" is the number of countries with solid political structures that are fleeing it as if *it* were the plague. In West Germany, despite high unemployment, a free-spending Social Democratic government is in trouble and a conservative Christian Democratic government is likely to take its place. In Britain, despite high unemployment, the Conservative government of Prime Minister Thatcher is showing signs of new popularity as its austerity policies begin to pay off in lower inflation, better business profits and smaller public borrowings. In France, where Socialist President François Mitterrand tried "reactivation" for a while, he is pulling back, despite high unemployment, under strong popular pressure to reduce government deficits and inflationary pressure on the franc.

The world gasps for liquidity not because the supply of money has contracted but because too much of it now goes to pay off old debts rather than fund new, productive investments. Note that net new Eurocurrency loans to developing countries shrank from $25 billion in 1977 to next to nothing last year, but meanwhile their interest payments doubled. Meanwhile, too, there was a massive shift into short-term debt to meet pressing payments problems—squeezing borrowers harder still.

The only tool available to slow down such a merry-go-round is the control of money-supply growth. That's the tool the U.S. Federal Reserve has been wielding since the fall of 1979 to force up interest rates to the point where they have become positive—higher than the inflation rate—for the first time in years. It was, and is, unpopular. But that's how Volcker broke the implicit alliance,

Money, money, everywhere

The chart shows the growth in Eurodollars and Eurobonds denominated in dollars—75% to 80% of the Euro markets—in the decade, now past, of credit's abundance.



It is a tribute to Mexico's strategic importance that Finance Minister Jesus Silva Herzog could get agreement on a $15 billion to $20 billion Marshall Plan-type aid package—the biggest international financial rescue ever attempted.

almost a conspiracy of silence, between governments and banks to go on ignoring the precarious health of the world's biggest borrowers. Now, both inflation and interest rates are coming down, but the interest rate remains above the inflation rate, as it must to prevent savings and the financial system from disintegrating.

Even though President López Portillo's *Partido Revolucionario Institucionalizado* (PRI) has ruled Mexico for half a century, it apparently does not feel politically secure enough to quit borrowing and cut public spending without first engaging in a noisy quarrel with the International Monetary Fund. They are among the "faith healers," Mexico's president says, who would starve the Mexican people and throw them out of work by demanding an end to undisciplined public spending before they lend money.

Clearly, there is a fair amount of political posturing in López Portillo's attacks on the IMF. But there is also the potential for trouble. The IMF can only help countries that demonstrate a willingness to help themselves. It lacks the resources to meet the needs and wishes of all the feckless borrowers and foolish bankers unable to avoid overextending themselves. Mexican policy at the moment is still in the hands of a lame-duck president until December, when López Portillo's successor, Miguel de la Madrid Hurtado, takes over. At the start of his six-year term, de la Madrid is likely to husband the financial affairs of Mexico more cautiously. But in these volatile times, given Mexico's problems and the world banking community's anxieties, two months is a long time to be going nowhere.

It is a tribute to Mexico's strategic importance and its power as an international borrower that Finance Minister Jesus Silva Herzog, a Yale-trained economist widely respected by foreign bankers, could make a quick trip to Washington on the weekend of Aug. 14 and come back with agreement on the main elements of the biggest international financial rescue ever attempted—at $15 billion to $20 billion, at least as big an aid package as the Marshall Plan after World War II, which went to several countries, not one. The funds were to be provided by the U.S. Treasury, several central banks through the Bank for International Settlements (BIS) in Basel and some private banks, nearly all contingent on a stabilization agreement with the IMF. But the IMF would provide its $4.5 billion share in loans only if Mexico agrees to cut its huge public spending and international payments deficits.

At at time when bankers' spirits seem almost as important as cold cash, de la Madrid's coming to terms with the IMF would be a powerful morale booster. If Mexico, the world's biggest debtor nation, were ready to accept a measure of self-discipline, it would then be possible to believe that the worst of the present liquidity crisis was over. After all, the bad news is already out, not only on Mexico but on Argentina, Chile, Costa Rica, Bolivia, Poland, Rumania, several small African states—they are de facto bankrupts. Other borrowers—Peru, Venezuela, Yugoslavia and, most important, Brazil—appear able to continue paying interest and amortization if a reasonable amount of liquidity remains in the system.

Brazil, whose default was widely feared two years ago but which continues to make payments on its $80 billion foreign debt, began in early 1981 to make massive cutbacks in imports, to cut subsidies and control public sector deficits and, above all, to borrow less. While Mexico and Argentina were printing lots of new money last month to "reactivate" their economies, Brazil's central bank was raising reserve requirements to tighten bank lending and force up interest rates.

For all that, Brazil, too, is a hostage to fortune. In consequence of past excesses, international lending is now at a virtual standstill. The immediate outlook is for a slowdown in trade, investment and economic growth. How fast these things will improve is beyond the reach of the most brilliant economists or inventive bankers. The world economy is in the hands of the politicians. ■

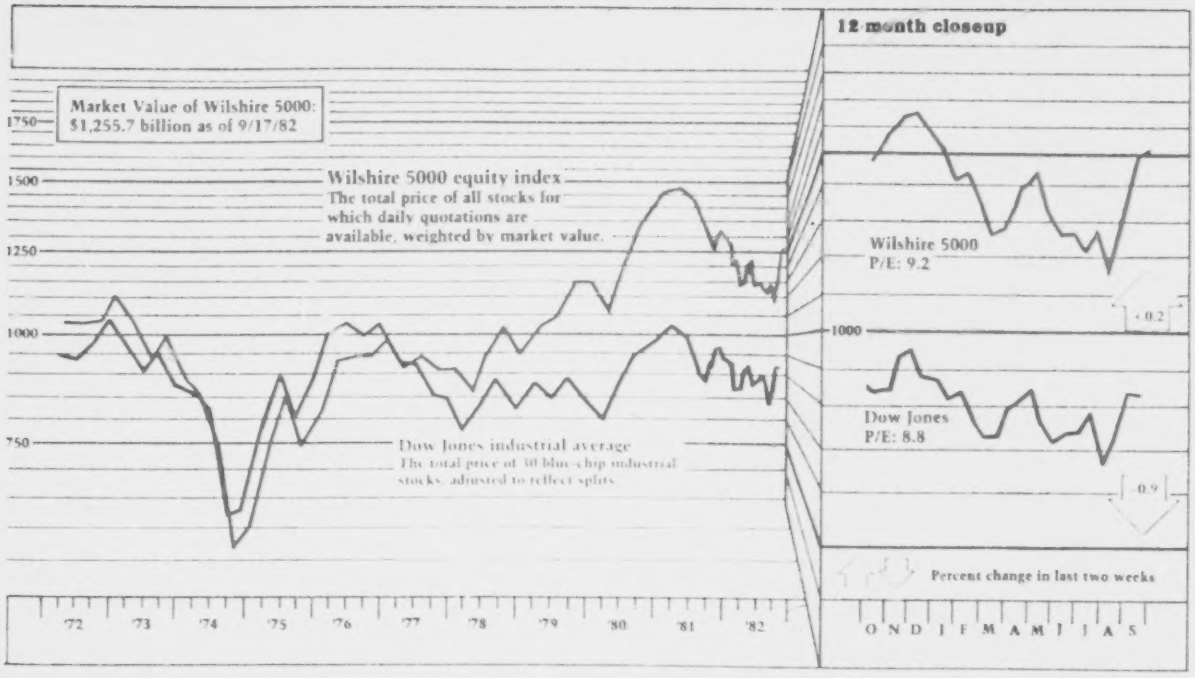
The last olé

President Jose Lopez Portillo was particularly critical in his State of the Nation speech Sept. 1 of those he charged had "looted" the Mexican economy. But Lopez Portillo himself appears to have done well out of his presidency, the culmination of a lifelong career in modestly paid public service.

Proceso, a Mexican magazine of the left, is causing something of a sensation in Mexico these days by suggesting that a $15 million mansion being built outside Mexico City belongs to the president. In addition, a duplex penthouse in Acapulco for the imminent Lopez Portillo retirement (Dec. 1) is described by an American furniture salesman as "something out of a fantasy." It may well be, as Mrs. Carmen Lopez Portillo has spent at least $150,000 in Dallas furniture showrooms on its decor, which includes a $70,000 custom-made spiral acrylic staircase.

The López Portillos: Off to Acapulco

The Forbes/Wilshire 5000 Review



Here come the cherry pickers. Despite some confusion among professionals about this summer's sudden market rally, the indexes continue to suggest the bull market is real—and expanding on cue. The Wilshire 5000, the best indicator of broad activity, climbed marginally in the past two weeks. The o-t-c index, however, showed the biggest jump, up 3.5% from the prior two-week period. And for the past four weeks the Amex index outpaced the others.

This is typical of previous long rallies. When the blue chips—best monitored by the Dow, which is now falling back slightly—become fully priced, investors begin shopping elsewhere. First it's the NYSE, then the Amex and finally the o-t-c market.

What are people buying over-the-counter? Companies like Paraho (oil shale recovery), Billings (hydrogen research) and Fonar (medical scanning equipment) show up among the percentage gainers. In short, the same sort of technology- and energy-related issues that have been popular over the past two weeks on the NYSE—just smaller companies with less float. The traditional cherry picking has begun. This is the first sign that individuals and smaller institutions are getting into the game.

Close-up On The Equity Markets

Performance of six leading indexes

Percent change	Wilshire 5000	Forbes 500[1]	Dow Jones industrials	NYSE Composite	Amex Market Value Index	NASDAQ Composite
in last 4 weeks	9.1	8.4	5.5	8.8	13.2	11.8
in last 52 weeks	2.9	N.A.	9.7	4.6	-3.7	1.3

Stock performance based on five key investor yardsticks

Percent change	Volatility[2]		P/E multiple		Dividend yield		Growth profile[3]		Share price	
	high	low	over 25	under 5	over 7.5%	none	high	low	over $40	under $4
in last 4 weeks	13.0	4.0	11.9	11.0	5.0	10.0	12.3	6.2	12.0	9.1
in last 52 weeks	10.4	12.8	-3.2	19.8	13.6	15.6	11.7	12.7	5.6	4.6

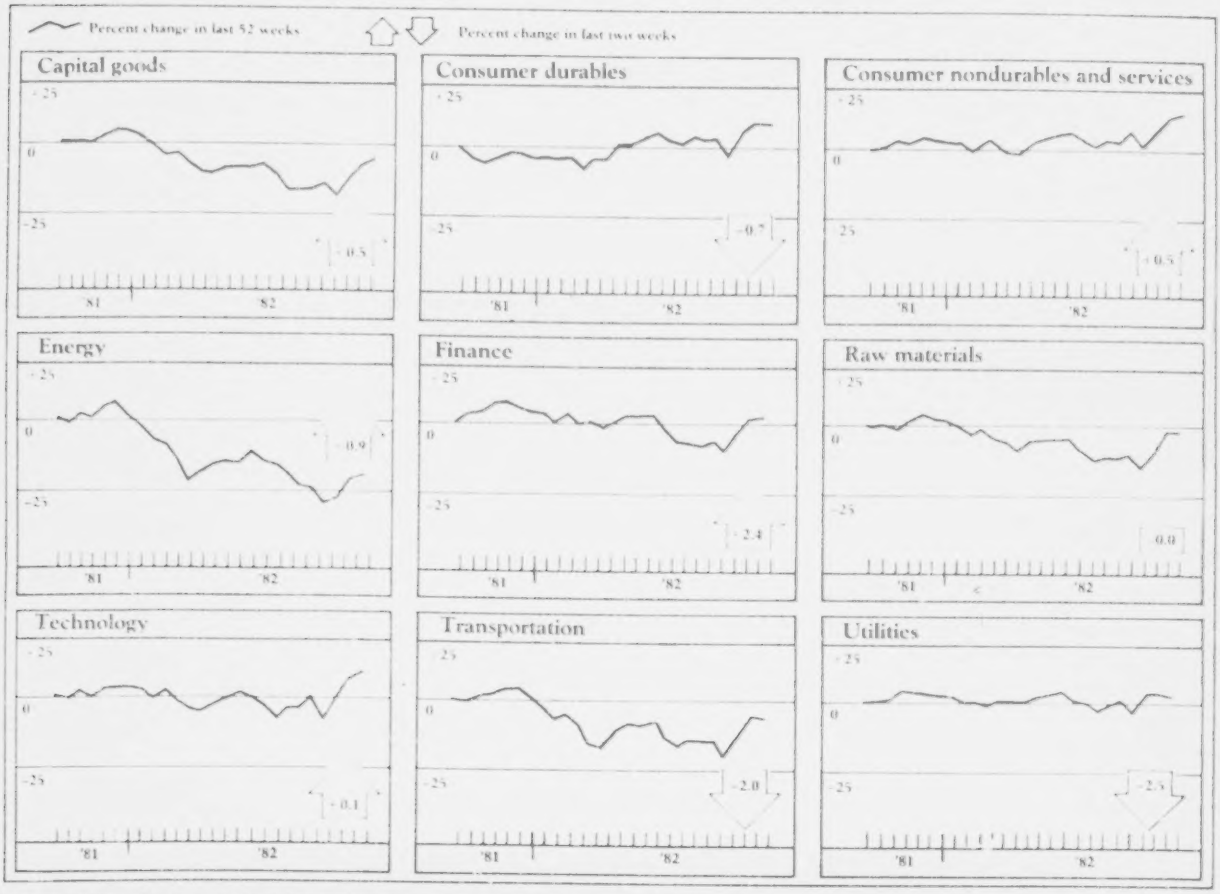
NA Not available
[1] Based on sales
[2] A stock's sensitivity to overall market movement. High volatility issues have wide price fluctuations, low volatility issues are more stable
[3] A quantitative evaluation of a stock's growth image determined by Wilshire Associates

Note: All data for periods ending 9/17/82. Prepared by Wilshire Associates, Santa Monica, Calif.

Where The Action Is

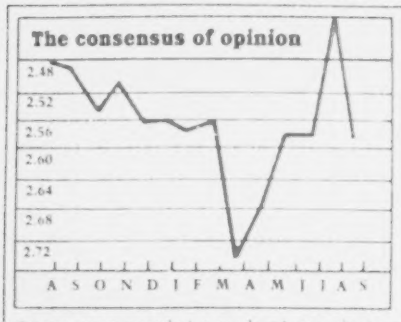
Energy on the upswing. After the worst 52-week performance of any sector, energy issues are beginning to breathe life. Energy showed the second-largest gains over both the last two and the last four weeks. Spot oil prices and heating oil prices are on the rise, and the result is sudden action in some of the oil issues.

Oil and gas exploration stocks showed up in the percentage gainers, including Damson Oil and Wilshire Oil. Other big movers were Tosco, a refiner, and Pioneer, which is big in natural gas. The two-week biggest climb, however, came from the finance sector. The leaders there are Merrill Lynch and other brokerage houses.



What The Analysts Think

The ride is over. Figuring, perhaps, that the fast ride up on the brokerage stocks is over, analysts moved financial issues to sixth place from second. Consumer nondurables, the 52-week darling, also fell — tumbling to seventh place from first. Now watch capital goods, the hard core of any recovery, which has moved up smartly.



Rank	Sector	Current opinion	Rank 2 weeks ago	Rank 4 weeks ago
1	Technology	2.31	3	2
2	Capital goods	2.50	6	3
3	Utilities	2.56	4	1
4	Energy	2.57	5	4
5	Transporation	2.61	7	6
6	Finance	2.64	2	5
7	Consumer non-durable	2.67	1	7
8	Raw materials	2.75	8	9
9	Consumer durables	2.92	9	8

Opinion ratings are ranked on a scale of 1 (strong buy) to 5 (strong sell). Data reflect the views of 200 institutional analysts. The consensus of opinion graph is the composite rating of 1,200 stocks, while the sector breakdowns correspond to industry groups graphed above. All figures are weighted for market capitalization.

Note: All data for periods ending 9/17/82. Prepared by Wilshire Associates, Santa Monica, Calif.